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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933

No. 62

FIRST NATIONAL BANK OF CINCINNATI and INTERNATIONAL HEATER COMPANY,

Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.

No. 63

FIRST NATIONAL BANK OF CINCINNATI and INTERNATIONAL HEATER COMPANY,

Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.

BRIEF FOR PETITIONER INTERNATIONAL HEATER COMPANY

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Conclusion: The decrees of the Circuit Court of Appeals and the District Court should be reversed; and in view of the fact that this petitioner has diligently done all that it could do to prevent the transfer of the assets of the defendant to the new corporation and has failed, and as the new corporation is a party to this suit, a judgment should be entered against the National Radiator Corporation of Maryland for $60,000.00, with interest and costs and disbursements 28

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BRIEF FOR PETITIONER

International Heater Company

This case comes before this Court on a writ of certiorari to the Circuit Court of Appeals for the Third Circuit issued May 27th, 1933. The decree to be reviewed was entered March 24th, 1933, and affirms a decree of the District Court for the Western District of Pennsylvania entered September 8th, 1932, confirming a sale by the receivers of the property of National Radiator Corporation and approving a plan of reorganization.

Opinions of the Court Below

The opinion of the United States Circuit Court of Appeals for the Third Circuit is reported in 64 Fed. (2d) 847. The opinions of Judge Gibson are not reported, but appear in the record at pages 280 and 463.

Jurisdiction

The jurisdiction arises from the granting of the writ of certiorari herein pursuant to Section 240a of the Judicial Act as amended by the Act of February 13, 1925.

Concise Statement of the Case

The complainants are a reorganization committee. They brought this suit to procure a sale of the property of the National Radiator Corporation as an entirety, for the purpose of carrying out their plan of reorganization.

The defendant National Radiator Corporation was organized in August, 1927, under the laws of Delaware, to acquire the property and business of six companies, all of which had been in successful operation over a long period of years. The combined earnings of the constituent companies before the consolidation had been much more than sufficient to meet the interest requirements on the $12,000,000.00 of debentures that were issued after the consolidation. Shortly after the consolidation, however, either through changed business conditions or through mismanagement, the company began to have heavy losses.

The defendant corporation lost $6,754,000.00 in three years, and the management, although the company still remained perfectly solvent, decided that a reorganization was necessary, and for that purpose requested John

H. Waters, chairman of the board, Rudolph B. Flershem, chairman of the executive committee, and Charles O. Cornell to act as a reorganization committee.

This reorganization committee formulated a plan of reorganization and obtained the consent of as many debentureholders and stockholders to its proposed plan as practicable and then brought this suit against the National Radiator Corporation, for the purpose of selling the corporate property so as to determine the amount to be received by those creditors who refused to assent to the plan. The corporation filed its answer, admitting all of the allegations of the complaint and joining in the prayer for relief.

Two receivers were appointed, who conducted the business from October, 1931, to March, 1932, apparently in the hope that the non-assenting creditors would see the light and consent to the plan. But as they did not, the receivers, represented by the same counsel who represented the reorganization committee, without notice to the debentureholders or other creditors who had not agreed to the plan proposed, applied to the District Court to fix an upset price and decree a sale. This was done and the sale was had and the property purchased for the reorganization committee and the sale confirmed.

The International Heater Company is not a debentureholder, but holds promissory notes of the defendant upon which there is due $60,000.00 and interest. Every other creditor not a debentureholder is to be paid in full; but this petitioner has been arbitrarily transferred from its own class into the security holder class.

Specification of Errors—Summary of Argument

1. The Courts below erred in permitting a sale to be made without giving the creditors an opportunity to be heard upon the question as to whether a sale as

an entirety was advisable and if it were, as to what the upset price should be. The District Court having before it only the evidence of those who were interested in purchasing the property as a whole at as low a price as possible, was naturally enough misled into including many unnecessary items in the sale and into fixing an inadequate upset price.

2. The Courts below erred in permitting every other creditor not a debentureholder to be paid in full, while compelling the International Heater Company either to make a permanent investment in its reorganized competitor or to accept a small and unknown percentage of its claim in cash.

POINT I

The creditors should have had notice of the application to sell the defendant's property and an opportunity to be heard as to the manner of selling and the amount of the upset price.

It is certainly desirable that stockholders and bondholders and debentureholders of an unsuccessful corporation should have a practical method of reorganizing the company by a suit in equity so as to continue the business if they so desire; but it is equally certain that those creditors or securityholders who wish to take their loss and get out should have an opportunity to do so; and they should receive in cash what they would receive if the company were liquidated in a manner to realize as much money as practicable. The difficult problem to solve is to determine how much they would receive on such a liquidation. Obviously if the corporation is to be reorganized the Court cannot conduct an actual liquidation. But the Court can ascertain roughly what the amount payable on a liquidation would be, by taking the evidence of those interested in a reorganiza-

tion and also taking the evidence of those preferring a liquidation. If the Court takes only the evidence of those interested in purchasing the property at as low a price as possible so as to continue the business, as was done by the District Court in this case, he naturally reaches the result that the property should be sold as a whole at a very low price. If the Court were to take only the evidence of those who desire to sell and whose witnesses would therefore fix the values at a very large amount, he would get an equally absurd result. Therefore, it is our contention that the only procedure for the Court to follow in order to do justice between these two conflicting interests, is to take the evidence of both and from that evidence to enter a decree as fair and just as circumstances permit. Of course this does not give an absolutely fair result, but it gives as fair a result as it is practicable to obtain, and certainly a much fairer result than taking the evidence of one side only.

The other petitioner, the First National Bank of Cincinnati, contends that the Court having taken custody of the property as trustee ought itself to make the necessary investigation to determine what is fair between those who desire to adopt the proposed plan and those who do not; that to require each small creditor to protect his own interest involves an expense disproportionate to the amount of many of the claims. Perhaps that is true. Certainly it is unfair to allow $300,000.00 of the purchase price (R. 307) to be used by the reorganizers to carry out their plan and allow nothing at all to the non-assenting creditors for the purpose of presenting their side of the case. Equitably the $300,000.00 should be taken out of the new corporation that presumably benefited by its expenditure and should not be paid by those who are injured by its expenditure. The present decree makes the non-assenting creditors alone pay their opponents expenses and allowances. We believe, however, that even though the Court does not itself have appraisals made and conduct an independent and impartial investi-

gation, but if it only gives all of the creditors an opportunity to be heard and to present their evidence in opposition to any proposed sale or plan, then they will find means adequately to protect themselves.

It cannot reasonably be contended that the District Court below did himself conduct an impartial investigation. All the testimony was given by those interested in selling the property in its entirety at as low a price as possible, and none by the creditors interested in selling it in any manner but at as high a price as possible. The testimony as to value was given by the president of the defendant, by his son, the vice president, and by the chairman of the executive committee, all vitally interested in the reorganization. The other receiver also testified but he was an attorney at law with no experience in the business (R. 256) and who, with the exception of the Johnstown and New Castle plants had never even seen the properties as to the value of which he was testifying. The attorney for the receivers was also the attorney for the reorganization committee.

Some of the evidence was taken at the office of the Bankers Trust Company in New York City and some at the office of the complainants' attorneys. Only the attorneys for the complainants, the defendant and the Bankers Trust Company were present at those hearings. Then the counsel for the First National Bank of Cincinnati fortunately learned of the proceedings and was present at the taking of the testimony before the District Court on March 3, 1932, and was permitted to cross-examine some of these interested witnesses. The International Heater Company never learned of the hearings until they were all over. It is plain therefore that the District Court did not act in a judicial capacity and try the issue between these parties; but simply assisted in one of the steps necessary to carry out the defendants' plan of reorganization.

These conflicts between those who desire to liquidate an

unsuccessful corporation and those who desire to reorganize it are bound to occur in many cases, particularly in times like these; and if justice is to be done it is necessary, as was said in substance in the *Coriell case* (289 U. S. 426) that the District Court adopt some procedure under which each of the parties may have a judicial determination of its rights. The Courts ought not to become simply a cog in the reorganization machinery.

It has been intimated that these petitioners are not worthy of much consideration, because as it is impossible to please everybody, and as 95% of the creditors seem to be satisfied these petitioners must either be acting in bad faith and trying unjustly to force a settlement, or are so unreasonable as to be impossible to satisfy. Neither of these things are true. It is not at all strange that the International Heater Company prefers any reasonable cash payment to investing in the securities of a mismanaged competitor; and we do not believe that any large portion of the creditors are really satisfied. In (a) and (b) below we shall give our reasons for this statement.

(a) *The objection of the International Heater Company to the plan is well founded.*

Its objection is fundamentally that the present management of the defendant, judging from its past history and present actions, can never be successful and the International Heater Company therefore does not wish to invest a dollar in that enterprise.

The constituent companies of the defendant had been in successful operation over a long period of years (R. 270). Their combined earnings had for the four years immediately preceding the consolidation averaged more than four times the interest requirements on the $12,000,000.00 of debentures issued (R. 271). The earnings of the defendant for the first four months of its existence in 1927 before "the management" had had time

to make changes, were $722,143.00 (R. 33). But the result for the next three years were the following net losses (R. 33):

1928	$1,343,491.00
1929	1,234,329.00
1930	1,453,870.00
	$4,031,690.00

Three of the Reorganization Committee say this sudden change from a large profit to a large loss was caused by "unfavorable competitive conditions in the industry" and "a drastic decline in residential building construction," afterwards "further aggravated by the industrial depression" (R. 33).

The name of the remaining member of that committee, however, appears signed to a statement that "adverse industrial conditions afford no proper alibi to the management of this company for their consistent record of failure, year after year"; that "during the last three years, competitive companies, under better management, have earned substantial profits." It gives as one of the reasons why creditors should not assent to the proposed plan the fact that the plan "fails to deal with the most vital question of management." It asks if the creditors "wish to perpetuate such a management" and sacrifice their rights so that that management may have a larger fund "to mismanage and fritter away." It says the losses have already been $6,574,000.00 and asks, "Are you willing to permit the balance of these assets to be mismanaged down to a zero?" (R. 385-386).

The International Heater Company is not willing to invest the funds it needs in its own business in a company whose assets it believes may be mismanaged down to a zero. It believes that it ought not to be compelled to make such an investment, but that it should receive the percentage in cash that would have been paid if the

defendant had been liquidated. And its view in that regard has not been changed by the fact that the men who signed this statement have turned over the debentures deposited with them to be used against the plan to be used by this "present management which proposes no remedy for its incompetence," in favor of the plan and to be counted among the 95% who are "satisfied." This change of heart on the part of this "Protective" committee did not change the facts as to the past history of this management. The International Heater Company was in the heating business and knew the facts. There was "unfavorable competition" before the consolidation as well as afterwards; and the years 1928 and 1929 were not years ordinarily included in "the industrial depression."

The danger of these *ex parte* hearings is shown by the fact that the Circuit Court of Appeals' opinion states as a fact that the defendant's difficulties were owing to a falling off of building construction, and "unfavorable competitive conditions," apparently without stopping to consider that some of the creditors believed and might have proved if they had had an opportunity that the losses were due mostly to mismanagement, and that therefore they considered the securities of the reorganized company of little value.

(b) *There is no good reason to believe that the holders of 95% of the debentures are satisfied with the plan.*

The fact that 95% of the debentures have finally been deposited under the plan really means nothing as to their being satisfied or as to the fairness of the plan. We all know how many holders of bonds and debentures send their securities to any committee, because they know of no better course to follow. They have not the resources to act separately. They do not know with whom to join to conduct an investigation. These debentureholders were told by the Reorganization Committee that if they did not join in the plan the only alternative was liquidation,

and that liquidation would "result in a very small payment to debentureholders and other creditors and might well prove disastrous, and would in any event leave nothing for the stockholders" (R. 35).

In the face of these statements, however, the holders of $851,000.00 face value of the debentures, or about 9% of them (R. 503), deposited them with a Protective committee to be used in opposition to the plan, but this Protective committee, without requiring any change in the management so severely criticized, except that Mr. Cahn, one of the committee, was to be added to the Reorganization Committee and the board of directors of the new company, upon being paid $35,000.00 for fees and expenses (R. 508), turned these debentures over to the Reorganization Committee to be used in favor of the plan. This 9% are part of the 95% classified as in favor of the plan.

It may well be, also, that some debentureholders were misled into depositing their debentures, for in March, 1931, when only a little over 60% of the debentures had been deposited, a letter was sent out by the Reorganization Committee with the following statement: "The corporation's present management assumed control of its affairs February 1, 1930. This is the same management which had active charge of the old National Radiator Company, of Johnstown, Pa., prior to its merger into the present corporation in 1927, and was responsible for building up that company over a period of years into the second largest earner in the industry" (R. 358); thus giving the impression that the management that was said to have been responsible for the company's losses had been changed. As a matter of fact no such change had been made. This same Johnstown management had been in charge from the beginning. Robert S. Waters, one of the receivers, had been vice president and general manager of the corporation from its organization to the receivership (R. 137). Carl E.

Resley, of Johnstown, Pa., testified that he had been secretary and treasurer ever since August 30, 1927, the time when the company was organized, except between January 1, 1929, and August 4, 1930, and that John H. Waters had been the chief executive officer (R. 129). John H. Waters had been chairman of the board from the organization of the corporation to the time of the application to sell; and after February 1, 1929, also held the office of president (R. 249-250). So if there was any change in the control of the corporation on February 1, 1930, it could not have been important.

The time taken and the strenuous efforts necessary to collect this 95% of debentures shows that the holders were not satisfied with the plan; but were afraid if they did not turn in their debentures they would get practically nothing.

If the District Court had given notice before the sale that he would conduct a real hearing as to what should be done with the property in his custody, then the creditors would have had a chance to act intelligently instead of being driven into the corral. There ought to be a procedure established, if it is not already well established, that every creditor should have his day in court on the question of the disposition to be made of his debtors' property; and he should not be refused a hearing and treated with disdain on the ground that he is interfering with a reorganization plan that large interests desire to have adopted.

(c) *The decree of sale was unfair and erroneous.*

It is undoubtedly possible that there might be a case where although parties were not given an opportunity to be heard, they nevertheless suffered no harm because the decision made was correct. That, however, cannot be true in this case, first, because it is impossible to know what the evidence is that would have been offered by the non-assenting parties if they had had an opportunity to offer

any, and secondly, that even on the evidence in this record, all given by the parties interested in selling at a low price, it is plain that the decision is not correct, but erroneous; for even that evidence shows that (1) there should have been a partial liquidation instead of a sale of all of the assets; (2) the sale should have been conducted so that there might have been an opportunity for real bids by persons other than this reorganization committee; and (3) the upset price should have been fixed at a higher amount.

1. *There should have been a partial liquidation.*

At the time of the application to sell there were on hand $1,929,807.59 of cash and items equivalent to cash. That amount of cash was not needed as working capital to conduct the little business that the company was doing. Two weeks after the appointment of the receivers they procured an order authorizing them to invest such amount of cash as was not needed for expenses and working capital (R. 521). They thereupon invested $1,030,000.00 (R. 257); and it remained so invested until the application for the sale. If this $1,030,000.00 was not necessary as working capital, why should it have been included in the sale? Apparently so that the upset price might appear reasonable, although in fact it was not reasonable, and so that the new company might in the future have ample working capital, if needed, without borrowing. As to the first reason, the courts ought not to assist in creating a deceptive upset price; and as to the second reason, if the new company is successful, it can obtain the necessary additional capital without withholding the money of these creditors, and if it is unsuccessful it will not need additional working capital.

There was also included in the property sold many other unnecessary items. Only two plants were being operated and those not nearly to their capacity. Apparently even under greatly improved conditions some of the plants would never be necessary. There should, therefore,

have been a real attempt to sell some of these separately. The Utica plant had been sold a short time before for more than $700,000.00 (R. 167), although it was a relatively small plant and its boiler manufacturing equipment was not sold but retained and taken to Newcastle. The defendant also owned warehouses in Chicago, Baltimore, Cincinnati, Richmond, Garden City and Washington, D. C., and an apartment hotel in Chicago (R. 141-142). It is evident that the business could have been conducted without some of these properties, which could, even in these times, have been sold for something and the proceeds distributed among the creditors, instead of being turned over to the reorganized corporation without any adequate consideration.

2. *The method of selling was too well adapted to exclude all bidders except the Reorganization Committee.*

The portion of the decree controlling the procedure of the sale occupies over twelve pages of the record (R. 297-309). It is complicated and enough to discourage anyone from bidding on a separate parcel. Moreover, it would be useless to bid on a separate parcel, because if the bid for the whole property (misleadingly called "Parcel K") is equal to or exceeds the aggregate of the bids for the separate parcels, then the bid for the whole, or "Parcel K," was to be accepted (R. 301).

The bid for the whole would almost inevitably be the larger unless the person desiring to bid on one of the separate properties should also be in a position to bid on "Parcel A," the upset price for which was $2,392,000.00 out of a total upset price of $2,500,000.00. This "Parcel A" included the two plants that were in operation, viz: the Johnstown and the Newcastle plants, and all of the quick assets, including the cash and equivalent to cash items, amounting to $1,929,807.59.

But for the privilege of bidding on Parcel "A," or any other parcel, one had to qualify (R. 302). The prospec-

tive bidder must, at least twenty-four hours before the sale, apparently so that the reorganization committee might have ample warning, deliver a pledge to make good the purchase and, unless they held sufficient debentures, as the reorganization committee did, must deposit cash or a certified check or checks for at least ten per cent of the upset price. Ten per cent of the upset price on Parcel "A" was $239,200.00. That was the amount, therefore, that a bidder must turn over to the receivers in order to be permitted to bid on this $2,000,000.00 of cash or its equivalent that was to be sold with the other assets, the cash items constituting about four-fifths of the upset price.

The purchaser was also "required to assume all obligations of the receivers under any then existing executory contracts, leases and agreements entered into, assumed or adopted by the receivers" (R. 306). As the District Court pointed out, this required the purchaser to some extent to buy "a pig in a poke" (R. 153). But Mr. Bennett, "who has been through a great many of these receiverships," thought that this was a very common form of decree; and the decree as printed was presented to the District Court and signed.

In the case of a sale that had to be brought before the Court for confirmation in any event and where there was therefore no opportunity for the purchaser to take an unjust advantage, it seems obvious that practically the sole purpose of these and other unreasonable restrictions scattered through this decree was to make it certain that the reorganization committee should get the property as planned.

3. *The upset price fixed by the District Court was obviously inadequate.*

The reorganization committee held a meeting on November 28, 1931, apparently for the purpose of planning the sale of the company's property. Among the things

considered was "the probable amount of the upset price" (R. 518). They estimated the liquidating value of the property at $3,600,000.00 (R. 518-519). They also considered the procedure and were advised that before the sale was held a hearing would be held as to the fairness of the plan and that notice would be given "to creditors and other parties in interest" (R. 518), and that then there would be "a final decree, fixing the date of actual sale." The District Court seems to have been much more favorable to them than was then contemplated because he made the final decree without the hearing and without the notice to creditors and fixed the upset price at more than a million dollars less than $3,600,000.00.

The defendant began business with assets of over $26,000,000.00 (R. 274). The plant values had been fixed by appraisal by Sanderson & Porter (R. 273). That these appraisals were then approximately correct is shown by the fact that the plant of the Utica Heater Company, which was appraised at $690,000.00, was shortly afterwards sold for $733,000.00, although the boiler equipment was held out of the sale and moved to Newcastle (R.); and this boiler equipment must have been of importance, for the Utica company made only boilers (R. 179).

By the time of the filing of the bill of complaint the book value of these assets had shrunk to $19,434,548.08 (R. 34). These are substantially what was sold for $2,550,000.00.

The receivers had at the time of the application to sell $852,096.29 in cash and $1,077,711.30 in the equivalent of cash, or a total of $1,929,807.59 of cash items. This the receivers conceded was worth its face value. Deducting that amount from $2,500,000.00, the upset price, leaves $570,192.41 as the price fixed by the Court for all of the other assets of this corporation. An examination of these other assets shows that several of them were alone worth far more than $570,192.41.

The receivers had accounts receivable amounting to $858,992.41, but they estimated that they could collect only one-fourth of this amount (R. 257). Most of these accounts had been created by the receivers themselves, for their sales from October 9th to December 1st, 1931, had been about $1,119,000.00 (R. 214). It is inconceivable, if they had used any care at all in selecting their credit risks, that only one-fourth of these new accounts so created by the receivers were collectible. If their statement is true, they should have been removed from their position as receivers. The theory that the accounts are uncollectible seems to be based upon the supposition that their customers would not pay a concern in liquidation as readily as a going concern; but we must keep in mind that most of these customers already knew when they purchased the goods that this concern was in the hands of receivers and might not continue to be a going concern, and we also know that a concern in liquidation has the advantage of being able to insist upon payment and to bring suit upon its claims without fear of losing the good will of the customer. If the receivers sold to solvent customers the accounts can be collected. If they have sold on credit $850,000.00 worth of merchandise which cannot be collected shortly after they made the sale, then they have wasted that amount of assets that belonged to the creditors, and they should be surcharged with the loss.

The receivers also had an inventory amounting to $1,634,905.25, or almost three times the upset price for the entire assets, excluding the cash items. But the receivers say that on liquidation this could only be sold for scrap (R. 257). If this testimony is true, what can be said in defense of using over a million and a half dollars of the creditors' money to create "scrap"; and how can the continuance of the business by such receivers under any circumstances be justified? No doubt it is true that on a liquidation this inventory would not bring as much as it would when sold by a going

concern, but to say that it is nothing but scrap is on the face of it prejudiced and unfair testimony; and the non-assenting creditors should have been given an opportunity to present to the Court evidence of its real value.

The receivers, however, made it appear to the Court that the corporation was worth less because it had these $858,992.41 and $1,634,905.25 items than it would have been if it had had no accounts receivable or inventory, because on the receivers' estimate these two items would bring to the corporation $214,498.10 for the accounts receivable and $163,490.52 for the inventory, or a total of $377,988.62. But it would cost $578,722.23 for liquidating, so that it would on this testimony have been cheaper to abandon the assets than to attempt to collect the accounts and sell the inventory.

Not only are the figures absurd on their face, but if we take into consideration the fact that there might be some loss in liquidation on the accounts receivable and a considerable loss on the inventory, nevertheless we must keep in mind that this buyer was not going to liquidate but was going to keep this business running and collect the accounts receivable in full and sell the inventory for approximately its face value. And if the business were so continued, then even the president of the corporation has to admit that the inventory can be sold without much loss (R. 253). Certainly if it could not, there was no justification whatever for the receivers creating it. If it could not be sold with the business continuing, then the expenditure of this money was pure waste.

As the business is to be continued by the reorganized corporation, and as these assets are to be sold for substantially their book value by the creditors who desire to continue the corporation, then in all justice and fairness the creditors who desire not to continue the corporation but to take the percentage they would receive on liquidation should have that percentage fairly deter-

mined after a fair hearing and should not be left to take practically nothing, on the theory that the business is to be liquidated, which it is not, and that if liquidated these assets would be "scrap," which is likewise not true.

The receivers also had on December 31, 1931, real estate, buildings, machinery and equipment having a book value of $6,635,842.84, which they say was worth on liquidation $500,000.00 (R. 258), although a short time before that the Utica plant alone, which was a relatively small plant, had been sold for $733,000.00. It is true that it is difficult to determine what the real value of these plants were, but the very fact that it is difficult makes it all the more important that the Court should have taken the testimony of both sides to the controversy and not have fixed the valuation on the testimony alone of those desiring to purchase.

The only real controversy before the District Court was as to the amount the creditors who desired to take their loss at the present time, whether through liquidation or otherwise, should receive. They desired to get as large a percentage of their claims as possible. Those who wished to continue the corporation and eliminate these non-assenting creditors were on the other hand desirous of paying them as little as possible. This was a very real controversy which a court has no means of determining with fairness and justice except by giving notice of a hearing for that purpose and giving the parties ample opportunity to present their evidence.

This failure to give the non-assenting creditors an opportunity to be heard was not a mistake or inadvertent, but was intentional. The petitioner, the First National Bank of Cincinnati, instead of being given notice, had to present its petition asking to intervene (R. 95-96). And not only the complainants but the defendant asked that that petition be dismissed; and the Bankers Trust Company denied its right to intervene. The petition of the International Heater Company asked that it be per-

mitted to intervene and offer its defense in the suit (R. 130-132). It was permitted to intervene but not to offer evidence (R. 133); which meant, in substance, that it could come into the suit and appeal without evidence except that introduced by its adversaries.

On the application to confirm the sale the attention of the District Court was called to the fact that that was the first opportunity the International Heater Company had had to appear in the proceeding and that if the Court desired to hear testimony as to the fairness of the plan, then the International Heater Company would like an opportunity to produce witnesses and introduce proof. The Court ruled that the petitioner might file any formal objections it desired, but that if it desired to introduce any testimony it must do so at that time (R. 394-396). Not having its witnesses in Pittsburgh, the petitioner was unable to introduce any testimony and its counsel could do nothing except as was done by the counsel for the First National Bank of Cincinnati in the former hearing, namely, cross-examine the witnesses sworn by the complainants.

Therefore, there can be no dispute about the fact that this petitioner had no notice whatever of the application to sell; and that after it was permitted to intervene it had no opportunity to offer evidence unless it had happened to have its witnesses in court on the day when the application to confirm the sale was returnable, although the receivers had then been conducting the business for about ten months and there was no apparent reason for haste.

We seem to have failed utterly in making it clear to the Circuit Court of Appeals that we had not had an opportunity to be heard. Speaking of the application to sell and the fixing of the upset price, that Court says the District Court "called upon all parties for evidence on the subject." The fact is this petitioner had no notice whatever of the application and only learned that there had been a hearing after it was all over, and then on

applying to the Court it was permitted not to offer any evidence but only to "intervene."

The opinion of the Court below goes on to say: "The complainants, at a hearing lasting four days, produced a mass of facts, figures and opinions; the objecting securityholders produced nothing." How could they produce anything when they did not even know there was a hearing? After they did hear of it they were not permitted to produce anything.

So, the opinion continues: "On the uncontradicted evidence, which was all he had to go on, the learned Judge set an upset price." If this petitioner had had any notice of the hearing or been permitted to offer any evidence after it did hear of it, this evidence would not have been uncontradicted and the District Court would have had a great deal more to go on.

Apparently if the Circuit Court of Appeals had understood the facts they would have decided in our favor for they seem to place much importance on the hearing and the evidence offered; but evidently did not understand that it was a hearing of one side only and that the other side had no notice whatever and therefore no opportunity to contradict the evidence introduced.

POINT II

The Courts below erred in permitting every other creditor not a debentureholder to be paid in full, while compelling the International Heater Company either to make a permanent investment in its mismanaged competitor or to accept a small and unknown percentage of its claim in cash.

The record does not show with clearness the origin of the International Heater Company's claim, nor of the facts regarding it; for this petitioner had no opportunity

to present evidence concerning it; but it did on the application to confirm the sale get into the record through the testimony of the president of the defendant corporation certain facts. It appears that at the time of the organization of the defendant the Lincoln Radiator Corporation was doing a successful business at Utica, New York, in the manufacture of radiation. The Utica Heater Company, the Continental Heater Corporation and the International Heater Company each owned one-third of the stock of the Lincoln Radiator Corporation. The first two of these became constituent companies of the defendant, National Radiator Corporation, which gave the defendant a two-thirds ownership in the Lincoln company. As part of the management of the defendant company which led to such remarkable results, the defendant closed the plant of the Niagara Radiator and Boiler Company, one of its constituent companies, at North Tonawanda, New York, in September or October, 1927, very shortly after the consolidation, although that was an old and successful company; and over the protest of the International Heater Company transferred the Lincoln company's business from Utica into this plant at North Tonawanda. The International Heater Company thus having its supply of radiation removed to a distance and its voice in the management of the Lincoln company practically destroyed, sold its interest to the defendant for what it could get and took five notes for $20,000.00 each in payment. Two of these notes were paid, and three remain unpaid. This reorganization committee insisted, and in this they have been so far upheld by the Courts, that while all of the other creditors except the debenture creditors should be paid in full, this petitioner should be arbitrarily put into the same class as the debentureholders who had voluntarily invested in the securities of the defendant.

It is to be inferred from the fact that at the time of the receivership this large corporation had creditors, outside of this petitioner and the debentureholders, with

claims amounting to only about $46,000.00, that this floating indebtedness had been reduced to that amount so as to conduct more easily this reorganization; and now this decree permits this remaining amount of indebtedness to be paid off, on the theory that it is good business for the reorganized corporation to have these debts paid and retain the good will of the various concerns with whom it had been dealing. There is no doubt about its being good business for the reorganized corporation to do this, in the same way that it was good business for it to purchase all of the defendant's property at less than its true value. But the question before the Court is not how the reorganized corporation can be best and most efficiently managed, but what is fair and just to all the creditors. We know of no rule of law, nor has any authority been cited in this litigation, showing that one creditor of a certain class can be discriminated against because its claim is larger than the others or because the reorganized corporation desires to retain the good will of the others but places no value on the good will of that particular creditor.

We seem to have been more successful on this point in the Court below than on our first point, because we not only succeeded in making clear what our point was, but that Court says the matter "is not free from difficulties" and that their trouble "has been in classifying the International Heater Company as a creditor, feeling that if properly classified its rights would be those of a class of which it is a member."

The Court below says, "It is not a merchandise creditor or a creditor in respect to debts currently incurred in the usual course of the corporation's business. It neither sold the corporation merchandise, nor rendered it service. It simply sold it shares of stock in another corporation." Therefore, they say, it is a general creditor and "stands on the same plane with holders of the debentures who, likewise, are general creditors."

Is this not a distinction without a difference? Are the Courts ready to establish a rule that the creditor who sold a thousand tons of coal shall be paid in full, but that the creditor who sold ten shares of stock must take a dividend that may be practically nothing? Is it the sale of stock alone that is to be thus discriminated against, or would the same rule apply to the sale of Liberty bonds? What is there so sacred in the sale of merchandise that gives the seller a first lien on the debtor's property?

The Court below goes on to say that "the International voluntarily became a general creditor of this corporation." This is another illustration of the difficulties that arise from our lack of opportunity to present evidence. The International did not voluntarily become a creditor. The consolidation gave the defendant two-thirds of the Lincoln company's stock and the power to mismanage the assets "down to a zero." Under these conditions the International salvaged what it could out of the Lincoln wreck, just as it is now trying to save what it can out of this wreck. It is voluntary only in the sense that it will not refuse to take whatever it can get.

We contend that there is no distinction at all between those creditors who sold the defendant pig iron and this one creditor that sold it stock. We believe, however, that there is a clear distinction between the security-holders who have voluntarily invested their funds in the defendant corporation and thus become more or less permanently interested in that enterprise, and those creditors like this petitioner that have only extended a temporary credit for what they believed was a short period of time.

While we find no case where this Court has definitely decided that such a distinction exists, it seems to us clear from the principles followed in prior cases of reorganizations that such will have to be the rule ultimately established.

In this case the debentures, except for the voluntary default for the purpose of this reorganization, would not have been due until August 1, 1947; while of the promissory notes held by the International Heater Company one was due December 31, 1931, one December 31, 1932, and the last one will be due on December 31, 1933.

The balance sheet annexed to the bill of complaint shows that the defendant could easily have paid the interest on the debentures and still have had over $1,000,000.00 in cash and over $3,000,000.00 of other quick assets. In other words, there was no necessity for a default in the interest payable at that time; and if there had been no default in interest, the principal would not have become due until 1947. The default was simply a part of the plan of reorganization. The purpose of the reorganization clearly appears in the record (R. 500). The chairman pointed out to the board of directors that "although the cash working capital of the company as shown by the balance sheet was reasonably ample, it was evident that, if the company were to do an increasing volume of business, it would require the use of all or a substantial part of its cash to carry larger inventories and receivables, and that it would also be necessary to make large expenditures for the design of new products and for equipment necessary in their manufacture." Otherwise, the chairman pointed out, "it might well prove to be impossible to maintain the company's competitive business as against other enterprises in the industry."

While the International Heater Company has no reason to object to a reorganization of the defendant corporation for the benefit of its stockholders and debentureholders if they desire so to reorganize, it has every reason to object to having its claim against this perfectly solvent corporation destroyed, and its money transferred to the defendant as reorganized, so that the International's competitor can "do an increasing volume of

business," "carry larger inventories and receivables" or "make large expenditures for the design of new products and for equipment necessary in their manufacture." Obviously, even if these things are for the benefit of the securityholders of this defendant corporation, they cannot benefit its competitor, the International Heater Company. If the defendant corporation needed increased working capital, that should have been furnished by those interested in the enterprise and not by the destruction through the Courts of the admittedly just claim of this creditor.

The International Heater Company has been placed in a worse position in this proceeding than it would have been if the defendant had become bankrupt, because if it had been adjudicated a bankrupt, there would have been a normal fair liquidation and distribution of its assets, and not a sale without bidders. The Court below, relying on the testimony of the defendant's officers, says the defendant was insolvent. If that were true and if it were insolvent to the extent that the Court below seemed to think, ought it not then to have been liquidated instead of reorganized? That Court was also much impressed by the supposition that 96% of the debentureholders had not protested; but it seemed to forget that 100% of the creditors who were not debentureholders and who were not to be paid in full, namely, the International Heater Company, were vigorously protesting.

This petitioner seems to have been caught in this case between the upper and nether millstones and left without a hearing or consideration of any kind. All of the other creditors in its class, that is, those that were not debentureholders, are to be or have been paid in full, and therefore have no interest in the proceedings. On the other hand, the whole reorganization plan is formed for the benefit of the securityholders, the stockholders and debentureholders. The plan which is annexed to the complaint says that "the management" requested

Messrs. Flershem, Cornell and Waters to act as a reorganization committee to formulate and submit to the securityholders a plan of reorganization "designed to accomplish the objects recommended by the management." The plan was to be submitted to the "securityholders" and not to this petitioner, and, of course, not to those that were to be paid in full. The committee's letter says that the board of directors and the committee are convinced that "unless this plan is carried out, the only alternative is liquidation, which will deprive all securityholders of any opportunity to participate in a revival of business following the present depression" (R. 36). In other words, while the corporation was not insolvent and could have kept on doing business, in which event this petitioner would have been paid, nevertheless the management have thought advisable that the right of this petitioner should be destroyed by a reorganization, so that the *securityholders* may have an opportunity to participate in the revival of business to follow the present depression.

The principle involved in the *Boyd* case (228 U. S. 482) goes much further than to establish a rule as to the relationship between stockholders and general creditors. It applies equally to the relationship between different classes of creditors. A plan that preferred unsecured creditors over bondholders whose bonds were secured by a mortgage would obviously be unfair and inequitable, for on a foreclosure sale the bondholders might well receive payment in full and the unsecured creditors receive nothing. The debentureholders in this case, however, are unsecured and have no preference. Their claim is that they are general creditors and that all creditors should be treated alike. In the case of a liquidation this would undoubtedly be true; but in a reorganization of a perfectly solvent corporation made for the benefit of these securityholders and against the interest of the short term creditors, we contend that it is not

true. The early maturity of the floating indebtedness constitutes a substantial and valuable preference to that class of creditors. That fact has been recognized by the defendant in case of all creditors except this petitioner with which it had had differences. It is perfectly plain that if this plan had not been adopted and the defendant had continued to do business until it did become insolvent, the International Heater Company and the other short term creditors would have been paid in full. At the time of the receivership the defendant had and it continued to have until the time of the transfer to the new corporation ample funds for that purpose.

When the securityholders decide to reorganize a perfectly solvent corporation because they believe that over a number of years it will be for their advantage to do so, they cannot legally or equitably deprive the creditors whose claims are due within so short a period that they would have been paid if the reorganization had not been made of this substantial priority, which was almost as great so long as the company remained solvent as if it were a secured claim.

This discrimination, intentionally or otherwise, against a single creditor, ought not to be permitted in any proceeding in any court of justice. All other creditors of the same general character have been or will be paid in full. Is it just or honest that this one creditor, because its claim is larger or because its relations with the persons running this reorganization were not so friendly, should be destroyed?

CONCLUSION

The decrees of the Circuit Court of Appeals and the District Court should be reversed; and in view of the fact that this petitioner has diligently done all that it could do to prevent the transfer of the assets of the defendant to the new corporation and has failed, and as the new corporation is a party to this suit, a judgment should be entered against the National Radiator Corporation of Maryland for $60,000.00, with interest and costs and disbursements.

Respectfully submitted,

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